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# In the Supreme Court of the United States

OCTOBER TERM, 1941

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

CREDIT ALLIANCE CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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# In the Supreme Court of the United States

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No.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

CREDIT ALLIANCE CORPORATION

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**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT**

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above-entitled case on July 21, 1941.

**OPINIONS BELOW**

The opinion of the Board of Tax Appeals (R. 1–16) is reported at 42 B. T. A. 1020. The opinion of the Circuit Court of Appeals (R. 23–29) is not yet reported.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 21, 1941. (R. 29–30.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

In 1936 taxpayer corporation made a liquidating distribution of earned surplus to its parent corporation, which resulted in no taxable gain or loss to the parent because of Section 112 (b) (6) of the Revenue Act of 1936. For the purpose of computing undistributed profits surtax, is taxpayer entitled to a dividends paid credit under Section 27 (f) of the Revenue Act of 1936?

## STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix.

## STATEMENT

The facts were stipulated (R. 20–23) and found by the Board as stipulated (R. 1–3). They may be summarized as follows:

Taxpayer corporation was organized in 1922, under the laws of New York, and was dissolved in July 1937. As of December 1, 1936, Commercial Credit Company, a Delaware corporation, owned 99.63% of taxpayer's outstanding capital stock; that corporation continued to own the same percentage of the taxpayer's stock until the dis-

solution of the taxpayer was complete. (R. 2, 21.)

In 1936 liquidation of the taxpayer was decided upon. Most of its assets were distributed in 1936. Further distribution was made in 1937, and the final distribution was made, completing liquidation, on November 30, 1938. The 1936 distribution was carried out by reducing capital stock from $4,225,488 to $528,186. This reduced the stated value of each share from $8 to $1. The distribution upon each share was $7 from capital and $1.80 from earned surplus. The total distribution of earned surplus thus effected was $950,734.80, of which Commercial Credit Company received $947,228.40. (R. 2–3, 21–22.)

Commercial Credit Company did not redistribute to its own stockholders any part of the distribution received by it from the taxpayer in 1936 (R. 3, 22).

In its income tax return for 1936 the taxpayer claimed a dividends paid credit under Sections 14 and 27 of the Revenue Act of 1936 for the full amount of that year's distribution of earnings and profits, namely, $950,734.80. The Commissioner allowed the credit to the extent of the amount distributed to minority stockholders, but disallowed it to the extent of $947,228.40, the amount distributed to the parent company. This resulted in the determination of a deficiency of $121,814.49 in the taxpayer's undistributed profits tax for 1936 (R. 1). The taxpayer filed a petition for redetermination, and the Board of Tax Appeals held

that there was no deficiency (R. 17). The court below affirmed (R. 30).

### SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in holding that taxpayer corporation was entitled, under Section 27 (f) of the Revenue Act of 1936, to a dividends paid credit for a tax-free liquidating distribution to its parent corporation.

### REASONS FOR GRANTING THE WRIT

Taxpayer made a liquidating distribution of earned surplus to its parent corporation in 1936. Although the distribution was not a taxable dividend in the hands of the parent company by reason of Section 112 (b) (6) of the Revenue Act of 1936, taxpayer contends that it is entitled to a dividends paid credit in the amount of the distribution under the provisions of Section 27 (f) of the 1936 Act. Section 27 (f) provides as follows:

> In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

The Commissioner, on the other hand, contends that Section 27 (f) is limited by Section 27 (h), and that under the provisions of the latter section

the dividends paid credit was properly disallowed. Section 27 (h) provides as follows:

> If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

The Commissioner further contends that, even if Section 27 (f) is not limited by Section 27 (h), no dividends paid credit is allowable because the liquidating distribution made by the taxpayer in 1936 was not "properly chargeable to the earnings or profits" within the meaning of Section 27 (f).

1. The court below, in holding that Section 27 (f) is not limited by Section 27 (h) and that the taxpayer is therefore entitled to a dividends paid credit notwithstanding that the distribution was tax free, rendered a decision in direct conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Centennial Oil Co.* v. *Thomas*, 109 F. (2d) 359, on the identical question.[1] This Court denied the taxpayer's petition for cer-

[1] The decision in the *Centennial Oil* case may also have been rested in part upon the view that a tax-free distribution is not "properly chargeable to the earnings or profits" of the taxpayer within the meaning of Section 27 (f).

tiorari in the *Centennial Oil Co.* case (309 U. S. 690); at that time no other case involving the question had been decided. Since the decision in the instant case the Second Circuit has decided the same point against the Government in *Commissioner* v. *Kay Mfg. Corp.*, decided August 5, 1941, not officially reported but found in 1941 C. C. H., Vol. 4, par. 9635, in which a petition for a writ of certiorari is being filed contemporaneously with this petition.

2. The further holding of the court below that the 1936 distribution of earned surplus was "properly chargeable to the earnings or profits" of the taxpayer within the meaning of Section 27 (f) appears inconsistent in principle with the decisions in *Commissioner* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2), certiorari denied, 287 U. S. 667; *United States* v. *Kauffman*, 62 F. (2d) 1045 (C. C. A. 9); and *Marchison's Estate* v. *Commissioner*, 76 F. (2d) 641 (C. C. A. 5). These cases establish that distributions of property by a corporation which, under Section 112 of the 1936 Act and the corresponding provisions of earlier Acts are received by the shareholder without the recognition of gain or loss, are not to be regarded as a distribution of earnings or profits for purposes of Section 115. Upon like principle, such a tax-free distribution of property should not be regarded as properly chargeable to earnings or profits for purposes of Section 27 (f).

It was in this view that the Treasury promulgated Article 27 (f)–1 of Regulations 94, providing that no dividends paid credit is allowable under Section 27 (f) with respect to distributions, such as the one here involved, which are tax-free under Section 112 and are, therefore, not regarded as a distribution of earnings or profits for purposes of the Act. In the light of the *Sansome* and other cases cited above, and of the fact that the theory of the regulation subsequently received legislative approval,[2] the regulation cannot be considered unreasonable. Under the controlling decisions of this Court, therefore, the regulation should have been given effect. *Helvering* v. *Reynolds*, 313 U. S. 428; *Morgan* v. *Commissioner*, 309 U. S. 78,

[2] Section 115 (h) (1) of the Revenue Act of 1938, which is a broadened version of Section 115 (h) (1) of the 1936 Act, specifically provides that the "distribution (whether before January 1, 1938, or on and after such date) to a distributee by or on behalf of a corporation of its stock or securities * * * or of property or money, shall not be considered a distribution of earnings or profits of any corporation * * * if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law * * *." This provision seems clearly applicable to Section 27 (g) of the 1938 Act, which is identical with Section 27 (f) of the 1936 Act, except that it is applicable only to the computation of surtax on improperly accumulated surplus and on personal holding company income, the undistributed profits tax having been repealed. See *Reed Drug Co.* v. *Commissioner*, 44 B. T. A. 573. The Committee reports make clear that the purpose of the amendment of Section 115 (h) (1) was to clarify and not to change the existing law. S. Rep. No. 2156, 74th Cong., 2d Sess., p. 19; S. Rep. No. 1567, 75th Cong., 3d Sess., pp. 18–19.

81; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Helvering* v. *Winmill*, 305 U. S. 79.

3. The precise question at issue here is involved in a number of pending cases,[3] which are being held in abeyance until the present case is disposed of, or which by stipulation are to abide the outcome of the present case.

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition should be granted.

CHARLES FAHY,
*Acting Solicitor General.*

OCTOBER 1941.

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[3] Among these are *Commissioner* v. *Ashville Citizen-Times Co.* (C. C. A. 4th); *Commissioner* v. *Biltmore Co.* (C. C. A. 4th); *Commissioner* v. *Avalon Paper Co.*, and related cases (C. C. A. 9th); *Commissioner* v. *California Brewing Assn. and Acme Breweries* (C. C. A. 9th); *Commissioner* v. *Desmond's Co.* (C. C. A. 9th); *Commissioner* v. *O'Donnell Oil & Securities Co.* (C. C. A. 9th); *Commissioner* v. *Oliver Ditson Co.* (C. C. A. 1st); and *Little Gem Coal Co.* v. *Commissioner*, 44 B. T. A. 755.

# APPENDIX

Revenue Act of 1936, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

* * * * *

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

* * * * *

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

* * * * *

(f) *Distributions in Liquidation.*—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall,

for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

* * * * * *

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * * *

(b) *Exchanges Solely in Kind.*—

* * * * * *

(6) PROPERTY RECEIVED BY CORPORATION ON COMPLETE LIQUIDATION OF ANOTHER.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater per-

centage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

* * * * * *

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or * * *

* * * * * *

Revenue Act of 1938, 52 Stat. 447:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 27 (f)-1. *Dividends paid credit for distributions in liquidation.*—(a) *Distributions which diminish earnings or profits.*—To the general rule that the dividends paid credit is allowable only with respect to taxable dividends paid, section 27 (f) makes one exception, namely, for that part of an amount distributed in liquidation which, under the Act, constitutes a distribution of, and is properly chargeable to, earnings or profits accumulated after February 28, 1913. Thus, a distribution either in complete or partial liquidation of a corporation is treated by the Act as one constituting in part a distribution of, and being properly chargeable to, earnings or profits, if—

(1) Under the provisions of section 115 (c), the amounts distributed in liquidation are treated as received in payment in exchange for the stock; and

(2) Under the provisions of section 112, the gain or loss, if any, from such exchange is recognized.

In such a case, a dividends paid credit is allowable for the amount actually involved in such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to the gain or loss realized and recognized upon an exchange, rather than that employed with respect to a taxable dividend.

On the other hand, certain transactions described in sections 112 and 115 are treated, for the purposes of the Act, not as distributions to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. No dividends paid credit is allowable with respect to such transactions.

(b) *Amount properly chargeable to earnings or profits.*—In the case of a distribution in liquidation with respect to which a dividends paid credit is allowable (see paragraph (a) of this article) the amount of the credit is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the

amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913.

(c) *Credit in respect of earnings or profits transferred under certain tax-free transactions.*—If, as a result of one or more transactions described in section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year, shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year subsequent to the consummation of such tax-free transaction may, subject to the provisions of section 115, be apportioned and allocated to the transferor as a distribution out of such earnings or profits of the transferor. The resolution of the board of directors of the transferee shall specifically designate the distribution, or part thereof, so apportioned and allocated. For the pur-

poses of the dividends paid credit, any such distribution so allocated shall be treated as a dividend paid only in the computation of the credit allowable to the transferor, and must be consistently so treated by both corporations for the current and succeeding taxable years. Each corporation shall file as a part of its returns for the taxable year involved, (1) a statement setting forth concisely all of the material facts, including the date and the character of the transaction under section 112, the status at that time of the earnings or profits of both corporations, the date and amount of all dividend distributions subsequently made, and the particular distribution or portion thereof designated as effecting a distribution of the earnings or profits of the transferor corporation; and (2) a certified copy of the resolution of the board of directors of the transferee corporation with respect to the distribution. No dividends paid credit based upon such apportionment and allocation will be allowed unless the Commissioner is satisfied that the transferor corporation is entitled thereto pursuant to the provisions of this paragraph and that there has been a full compliance with the requirements of this paragraph.

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